

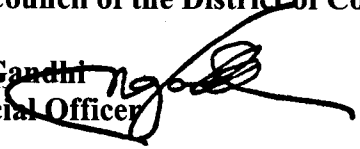
**Government of the District of Columbia
Office of the Chief Financial Officer**



Natwar M. Gandhi
Chief Financial Officer

MEMORANDUM

TO: The Honorable Vincent C. Gray
Chairman, Council of the District of Columbia

FROM: Natwar M. Gandhi 
Chief Financial Officer

DATE: November 14, 2008

SUBJECT: Fiscal Impact Statement: "Small Business Loan Authority Act of 2008"

REFERENCE: Draft Legislation – No Bill Number

Conclusion

Funds are sufficient in the FY09 budget and FY09 – FY12 financial plan to implement the proposed legislation.

The legislation authorizes the Mayor to continue or increase investments in, and loans to, the Neighborhood Economic Development Corporation (NEDCO) in an amount that is not capped. Although a continuation of the District's current investment in NEDCO does not have a fiscal impact, we estimate that approximately \$2 million of the District's original \$6.05 million investment may be returned to the District's general fund if NEDCO were to be liquidated. Also, the District's existing investment is at risk of a future decrease in value, and any such decrease would further reduce the District's net assets (which reduction, however, has no impact on the budget and financial plan because the value of assets is not included in the financial plan). Finally, it is the understanding of the Office of the Chief Financial Officer (OCFO) that any increase of investment in NEDCO would require budget authority.

Background

NEDCO was incorporated in 1985 with the stated purpose to "stimulate economic development within neighborhoods of the District of Columbia" by investing in, or making loans to,

businesses engaged in activities deemed to "contribute to the revitalization and improvement of economic conditions within the District of Columbia."

NEDCO was organized with two classes of common stockholders: Class A and Class B. Most of the Class A shares are held by private financial institutions, while the District-created Economic Development Finance Corporation (EDFC) purchased 100% of the Class B shares (in 1987) at a cost of \$3.025 million. EDFC, a quasi-public entity established by Council Act in 1984, was assumed into the National Capital Revitalization Corporation (NCRC) upon repeal of the EDFC Act in 2002. When NCRC was dissolved under legislation effective in 2007, the assets of NCRC, including the former assets of EDFC, were transferred to the control of the Office of the Deputy Mayor for Economic Development (ODMPED).

In 1988 EDFC acquired, with funds appropriated by the District, a 20-year subordinated debenture of NEDCO in the amount of \$3.025 million (the "original debenture"), increasing the District's total investment in NEDCO to \$6.05 million. The original debenture matured on November 19, 2007. In November 2007, according to the legislation, the NEDCO board voted to make a 4% dividend payment to all stockholders (including a \$121,000 payment to the District) as well as a partial payment of interest due under the debenture, equal to \$879,000, for a total of \$1 million.¹ At that time, ODMPED and NEDCO executed a new \$3.025 million subordinated debenture which matured on May 19, 2008 (the "second debenture"). The second debenture contained the same interest rate and business terms as the original debenture except that if, prior to May 19, 2008, a determination was made to liquidate NEDCO, any payments made to the District under the original debenture would be treated as a return of capital to the Class B stockholders (the District).

NEDCO and the District have not executed a new debenture or extended the second debenture subsequent to the May 19, 2008 expiration date, but no funds have been paid to the District other than the \$1 million paid in 2007.

Although NEDCO does not have recent audited financial statements, the OCFO understands that NEDCO has been a dormant entity for at least the past two years. Recent bank statements showed that NEDCO held approximately \$10 million in bank deposits. NEDCO reports it holds no loans and has no significant liabilities.

If NEDCO were to be liquidated, the District would receive approximately \$2 million of NEDCO's assets, while the remaining \$8 million would go to the private shareholders.² This disproportion is due to the subordination provisions of both the District's debenture and equity investment and takes into account the \$1 million already received by the District.

Financial Plan Impact

Assuming the Mayor does not increase the investment in NEDCO as authorized by the proposed legislation, the proposed legislation will not impact the FY 2009 budget or the FY 2009 – 2012

¹ The original debenture paid simple interest only upon maturity at the rate of three percent. On November 19, 2007, interest in the amount of \$1,815,000 was due.

budget and financial plan. It does carry a risk of a decrease in the net assets of the District over the four-year period; however, the value of assets is not included in the budget and financial plan.

Other Comments

After examining NEDCO documents, the OCFO has determined that there are some statements in the proposed legislation's findings which may require clarification³:

1. The legislation states that "NEDCO is a non-profit organization."
 - According to our examination, NEDCO is a for-profit corporation.
2. That legislation states that "the Class A stockholders have the right to elect 7 members of the board of directors of NEDCO. The Class B stockholders have the right to elect 11 members of the board of directors of NEDCO."
 - According to our examination, the Class A stockholders have the right to elect 7 members of the Board of Directors, while the Class B stockholder (the District) has the right to elect only 4 members.⁴
3. The legislation states that "an Amendment to the Articles of Incorporation requires approval of 100% of the holders of Class B stock."
 - According to our examination, amendments to the Articles of Incorporation also require approval of 80% of the Board of Directors and two-thirds of the Class A (private entity) stockholders.

A continued or increased investment in NEDCO creates a number of risks for the District, including:

- 1) The private shareholders of NEDCO have a highly favorable preference of return of capital. NEDCO operating expenses and declines in the values of any loans made to small businesses would negatively impact the District's debenture and equity investment before impacting the equity of the private institutions. Likewise, positive returns in NEDCO's lending portfolio would benefit the private shareholders disproportionately.
- 2) The District's objectives as outlined in the proposed legislation may not be achieved because the District does not control NEDCO operations or decision-making authority at

² This estimate is based on discussions with NEDCO's Board Chair and attorney. Determination of the exact amount would require an audit of NEDCO's books and operations.

³In addition, the District's participation in NEDCO may be challenged. The proposed legislation places private parties in control of the District's invested funds (including any additional investments made at the Mayor's discretion). Sections 424d(10) and 424d(12) of the Home Rule Act were added to the Home Rule Act in 2006 and require the Chief Financial Officer to maintain custody of all public funds and invested funds of the District government. In addition, section 602(a)(2) of the Home Rule Act states that the Council shall have no authority to "lend the public credit in support of any private undertaking." but the NEDCO structure essentially renders the District's participation a guaranty of private loans to private borrowers.

⁴ This minority-District vote is contained in the existing NEDCO Articles of Incorporation and By-laws, and the Chair of the NEDCO Board confirmed that these documents have not been amended to change the numbers of Board members.

the Board level. In addition, NEDCO currently does not have a lending strategy in place that could be compared against the proposed legislation's objectives.⁵

⁵ Section 4 of the proposed legislation contains language allowing the Mayor to issue rules to establish NEDCO's lending standards, but NEDCO is a private corporation and its lending standards are subject to NEDCO authority.